KUWAIT FINANCE HOUSE (MALAYSIA) BHD A

v.

VESTA ENERGY SDN BHD & ORS

HIGH COURT MALAYA, KUALA LUMPUR B
MOHD ZAWAWI SALLEH J
[SUIT NO: 22A (MUAMALAT)-161-02/2012]
14 AUGUST 2012

BANKS AND BANKING BUSINESS: *Islamic banking - Action to recover monies under various Islamic facilities - Whether Islamic facilities unenforceable - Whether involved elements of riba and gharar - Whether plaintiff could enforce its rights - Whether plaintiff at liberty to proceed against defendants under facilities agreements* C

CIVIL PROCEDURE: *Summary judgment - Action - Action to recover monies due under various Islamic facilities - Whether plaintiff at liberty to proceed against defendants under facilities agreements - Triable issues - Whether existed* D

The plaintiff filed the instant action to recover monies due under various Islamic facilities it had granted to the first defendant and which were guaranteed by the second to the fourth defendants. The plaintiff applied for summary judgment of its claim. In opposing the application, the defendants, *inter alia*, contended that (i) the plaintiff was estopped from making its claim in view of the fact the parties had reached a compromise and settlement under which the plaintiff had received six post-dated cheques from the first defendant; (ii) the Islamic facilities were unenforceable because they involved elements of *riba* (*ie*, element of interest in the levying of late fee charges and demanding of a higher amount than that disbursed) and *gharar* (*ie*, the loans were used in high risk and speculative ventures) which were prohibited in Islam; and (iii) the plaintiff should have claimed against a third party company ('Chunghwa') in which the first defendant had invested, the profits from which investment the first defendant had wholly assigned to the plaintiff under a deed of assignment. E F G H

Held (allowing application with costs):

(1) The documentary evidence showed the six post-dated cheques were accepted by the plaintiff on a without-prejudice basis and that it was not to be construed as a waiver, forbearance or indulgence of any breach or default by the defendants. It was I

A expressly stated that the cheques would be used to reduce the sum owing to the plaintiff. The parties had also agreed that any amendment, modification, waiver or termination of the facilities agreements would be in compliance with strict requirements under the agreements themselves. Therefore, the B plaintiff was at liberty to proceed against the defendants as provided under the facilities agreements. (para 70).

(2) On the premises of the case, there was no issue on riba. The lexical meaning of riba is increase. However, not every increase C is prohibited in Islam. (para 45)

(3) The risk as alleged by the defendants in the investment undertaken by themselves was not *gharar* but *ghorm*. Therefore, the plaintiff should not be dragged into the loss suffered by the defendants as the transaction herein was not D on *mudharabah* or *musharakah* basis but *ijarah* and *murabahah* based where the underlying assets were not the investment in the said company. (para 67)

Case(s) referred to:

E *Bank Islam Malaysia Berhad v. Adnan Omar [1994] 3 CLJ 735 HC* ***(refd)***

Bank Islam Malaysia Bhd v. Helcom Engineering Corporation Sdn Bhd & 2 Lagi (Guaman No: D22A-23-2011) (Unreported) ***(refd)***

CIMB Islamic Bank Bhd v. LCL Corporation Bhd & Anor [2011] 7 CLJ 594 HC ***(refd)***

F *Mohd Alias Ibrahim v. RHB Bank Bhd & Anor [2011] 4 CLJ 654 HC* ***(refd)***

RHB Islamic Bank Berhad v. Veheng Global Trader Sdn Bhd & Ors [2011] 1 LNS 684 HC ***(refd)***

Legislation referred to:

G Banking And Financial Institutions Act 1989, s. 123(3)

Central Bank Act 1958, ss. 16B(4), 51(8)

Contracts Act 1950, s. 8

Islamic Banking Act 1983, ss. 3(5), 5(a), (b), 13A(1)

Other source(s) referred to:

H Maulana Justice Muhammad Taqi Usmani, *The Text of the Historic Judgment on Riba 23 December 1999*, The Other Press, 2001, pp 32 & 3

Shariah Resolutions In Islamic Finance, Central Bank of Malaysia, 2007, 1st edn, p 62

I *Shariah Resolutions In Islamic Finance,* Central Bank of Malaysia, 2010, 2nd edn, pp 219, 224

The Principles and Practices of Shariah in Islamic Finance, Shariah Parameter Reference 1: Murabahah, Central Bank of Malaysia, p 4
Understanding Risk and Uncertainty in Islam: Gharar versus Ghorm, Critical Issues on Islamic Banking And Financial Markets, Dinamas Publishing, 2008, pp 73-76
Wan Marhaini Wan Ahmad, *Some Issues of Gharar (Uncertainty) In Insurance, Essential Readings in Islamic Finance,* Centre For Research And Training (CERT), 2008, pp 251-253

For the plaintiff - SM Yoong (Marianne Loh with her); M/s Shook Lin & Bok
For the defendants - SS Kumar; M/s Kumar & Assocs

Reported by Ashok Kumar

JUDGMENT

Mohd Zawawi Salleh J:

Introduction

[1] The plaintiff had filed an application for summary judgment against the defendants in encl. (17), praying for final judgment to be entered against the defendants for the sum set out in para. 8 of the plaintiff's affidavit in reply (2), affirmed on 19 June 2012, as follows:

(i) **Murabahah Tawarruq 2**

RM811,745 as at 15 June 2012 with a compensation fee thereafter at the plaintiff's current Islamic Money Market rate (R-Rate) per annum on the sum of RM764,619.77 on a non-compounded basis from 16 June 2012 until the date of full settlement.

(ii) **Ijarah 1**

RM2,827,022.29 as at 10 February 2012 with further compensation fee at 1% per annum thereon from 11 February 2012 to the date of full settlement.

(iii) **Ijarah 2**

RM32,519,351.36 as at 10 February 2012 with further compensation fee at 19% per annum thereon from 11 February 2012 to the date of full settlement; and

A (iv) **Ijarah 3**

RM29,010,466.86 as at 27 September 2011 with a compensation fee at the plaintiff's current Islamic Money Market rate (R-Rate) per annum from 28 September 2011, to
B the date of full settlement.

[2] I heard the application on 27 June 2012 wherein at its conclusion, I allowed the application with costs fixed at RM5,000.

The Facts Of The Case

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[3] By way of background, it is material to state the facts which gave rise to the present application.

[4] The plaintiff's claim is for recovery of monies due from the
D defendants in respect of Islamic facilities granted to the first defendant and as guaranteed by the second defendant to the fourth defendants.

[5] These facilities are:

E (a) Three (3) *ijarah* facilities; ie, *Ijarah* 1 of RM14,000,000, *Ijarah* 2 of RM60,000,000 and *Ijarah* 3 of RM37,000,000; and

(b) A *Mubarabah Tawarruq* facility of RM1,000,000.

[6] The *ijarah* 1 facility was granted pursuant to the plaintiff's
F letter of offer dated 18 April 2006 ("the 1st letter of offer") issued by the plaintiff.

[7] Pursuant to the 1st letter of offer, the plaintiff and the first defendant had executed, *inter alia*, the *Al-Ijarah* Agreement dated
G 10 May 2006 ("the *Ijarah* 1 Facility Agreement") and the Asset Purchase Agreement dated 10 May 2006.

[8] The *ijarah* 2 and *murabahah tawarruq* facilities were granted under a letter of offer dated 11 June 2007 ("the 2nd letter of
H offer") issued by the plaintiff whereby other facilities were also granted to the first defendant.

[9] Pursuant to the 2nd letter of offer, the plaintiff and the first defendant entered into, *inter alia*, a Master *Ijarah* 2 Facility Agreement dated 10 August 2007 ("*Ijarah* 2 Facility Agreement")
I and a *Murabahah Tawarruq* Facility Agreement dated 26 June 2007.

[10] By a letter of offer dated 26 October 2009 ("the 3rd letter of offer") issued by the plaintiff, the plaintiff granted further additional facilities to the first defendant including the *Ijarah Financing* 3 facility.

[11] Pursuant to the 3rd letter of offer, the plaintiff and the 1st defendant entered into an *Ijarah Muntahiah Bitamlik* Contract Financing-i III Facility Agreement dated 24 December 2009 ("the *Ijarah* 3 Facility Agreement") and the Master Asset Purchase Agreement dated 24 December 2009.

[12] By the terms of the *Murabahah Tawarruq Facility* Agreement, the following are salient:

(a) the first defendant will request the plaintiff to purchase the assets and the first defendant will provide an undertaking to buy the goods from the plaintiff at the deferred sale price (which is made up of the purchase price of the assets, profit and commodity supplier's fees) and which is payable on deferred payment basis;

(b) the *Murabahah Tawarruq* facility has been duly utilised;

(c) the profit payable to the plaintiff is 1.0% above the plaintiff's Base Financing Rate ("BFR") per annum;

(d) a compensation fee *(at-ta'widh)* shall be charged by the plaintiff on all outstanding instalment payments until maturity date of the facility at the rate of 1% per annum and at the plaintiff's Islamic Money Market at (the R-rate) on the balance of the deferred sale price beyond the maturity date;

(e) in the event of default by the first defendant in the payment of any sum or instalments due under the *Murabahah Tawarruq* facility to the plaintiff, payment of the deferred sale prices are immediately payable to the plaintiff upon demand; and

(f) the first defendant is liable to pay the plaintiff's costs on solicitors and clients basis.

[13] By the terms of the *Ijarah* 1, 2 and 3 Facility Agreements, the following terms are salient:

A (a) that the first defendant will sell the beneficial ownership of certain assets to the plaintiff and the plaintiff will immediately lease the assets to the first defendant whereby the first defendant will pay monthly lease rentals to the plaintiff during the lease term;

B (b) upon termination of the lease term of the assets, the first defendant is required to purchase and pay to the plaintiff the exercise price as set out in the put option by the plaintiff pursuant to the first defendant's undertaking to do so under C the said facilities; and

(c) to pay the plaintiff compensation fee *(at-ta'widh)* at the rate as specified in the facility agreements for any instalments and/ or indebtedness on a non-compounded basis.

D **[14]** By a letter of guarantee dated 10 May 2006, the second, third and fourth defendants jointly and severally guaranteed to the plaintiff not merely as sureties but also as principal debtors, the payment on demand of all monies due and owing by the first defendant to the plaintiff under the *ijarah* 1 and letter of credit E facilities.

[15] By a guarantee and indemnity dated 26 June 2007, the second, third and fourth defendants jointly and severally guaranteed to the plaintiff again as principal debtors, the payment F on demand of all monies due and owing by the first defendant to the plaintiff, under the *ijarah* 2 and *murabahah tawarruq* 2 facilities.

[16] By a joint and several guarantee and indemnity dated 24 December 2009, the second, third and fourth defendants G jointly and severally guaranteed to the plaintiff also as principal debtors, payment on demand of all monies due and owing by the first defendant to the plaintiff under the *Ijara*h 3 facility.

[17] The first defendant has fully utilised the said facilities but defaulted in payment to the plaintiff.

H **[18]** The plaintiff, through its solicitors herein, Messrs. Shook Lin & Bok, issued letters dated 18 May 2011 to the first defendant declaring that an event of default had occurred and that payments of the deferred sale price under the *Murabahah Tawarruq* facility

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had been accelerated and was immediately payable to the plaintiff. The plaintiff also terminated the lease under the *Ijarah* 1 and *Ijarah* 2 facilities and demanded the first defendant to purchase the assets financed by the plaintiff under the *Ijarah* 1 and *Ijarah* 2 facilities.

[19] The plaintiff, through its said solicitors, issued letters dated 14 July 2011 to the first defendant declaring that an event of default had occurred for the *Ijarah* 3 facility and terminated the lease under *Ijarah* 3 facility and demanded the first defendant to purchase the assets financed by the plaintiff under the *Ijarah* 3 facility.

[20] The first defendant failed to make the payments as demanded.

[21] The plaintiff has issued the Put Option Certificates dated 19 May 2011, 10 November 2011 and 19 July 2011 to the first defendant under the *Ijarah* 1, 2 and 3 facilities respectively, requiring the first defendant to pay the respective exercise prices thereunder and to execute the relevant sale agreements in relation thereto:

Put Option Certificate Date	Exercise Price (RM)
(a) 19 May 2011	2,936,225.66
(b) 10 November 2011	34,449,462.64
(c) 19 July 2011	35,812,198.68

[22] Despite the aforesaid, the first defendant has failed, neglected and/or refused to pay the exercise prices under the *Ijarah* 1, 2 and 3 facilities respectively, in breach of the first defendant's obligations.

[23] The plaintiff has exercised its right under the Memorandum of Deposit of General Investment Account Receipts and Set-Off *Ijarah* III dated 24 December 2009, whereby the plaintiff had uplifted the deposits pledged therein and utilised RM 6,947,873.40 to reduce the amount of indebtedness due and owing by the first defendant under the *Ijarah* 3 facility.

[24] The plaintiff through its solicitors herein, Messrs. Shook Lin & Bok, have issued letters 10 October 2011 and 11 January 2012 respectively to the first defendant demanding payment of the exercise prices owing by the first defendant under the *Ijarah* 1, 2 and 3 facilities.

[25] The plaintiff have also through its said solicitors, issued letters dated 27 January 2012 to the second, third and fourth defendants demanding payment of the total outstanding sums owing by the first defendant under the *Ijarah* 1, 2, 3 and the *Murabahah Tawarruq* facilities.

[26] The defendants have all failed to effect payments to the plaintiff.

[27] On 10 February 2012, the plaintiff has exercised its right to uplift the monies pledged by the first defendant and utilized RM 1,691,384.14 to reduce the amount of indebtedness due and owing by the first defendant under the *Ijarah* 1, 2 and *Murabahah Tawarruq* facilities.

[28] Subsequently on 11 May 2012 and 5 June 2012, the plaintiff has also banked in two post-dated cheques given by the first defendant totalling RM 200,000 which was received on a without prejudice basis, towards partial reduction of the defendants' outstanding balance under the *Murabahah Tawarruq* facility.

Purported Triable Issues

[29] In resisting this instant application, learned counsel for the defendants had raised the following issues:

(a) whether the *Murabahah Tawarruq* 2, *Ijarah* 1, *Ijarah* 2 and *Ijarah* 3 facilities are enforceable when the transactions involved elements of *riba* and *gharar*;

(b) whether there is an accord and settlement between the plaintiff and the first defendant when the six (6) post-dated cheques were given to the plaintiff;

(c) whether the plaintiff is estopped from relying on the facilities agreements when a settlement has been reached between the plaintiff and the first defendant; and

(d) whether the plaintiff should claim against Chunghwa Picture Tubes (Malaysia) Sdn Bhd pursuant to the Deed of Assignment executed in its favour.

Arguments By The Plaintiff

[30] In response to the above, it was submitted on behalf of the plaintiff that the issues raised by the defendants were contrary to, and inconsistent with, the contemporary documents and were inherently improbable. This was due to the following reasons:

(a) nothing in the facilities agreements indicate any charging of interest and the present action does not include any claim for interest;

(b) element of *gharar* in the projects themselves (if any) are irrelevant as the risk of undertaking the projects is borne solely by the first defendant and not the plaintiff as the financier;

(c) the six (6) post-dated cheques were accepted by the plaintiff on without prejudice basis and it was not to be construed as a waiver, forbearance or indulgence of any breach or default by the defendants. Hence, there was no accord and settlement between the parties; and

(d) the Deed of Assignment is merely a security given to the plaintiff. Therefore, the plaintiff is entitled to pursue concurrent or simultaneous remedies against the first defendant to recover all monies due.

Findings Of The Court

[31]`Perhaps the argument which is probably most frequently advanced by the counsels to escape liability from paying all the outstanding sums due and owing to the plaintiff under Islamic banking is that the plaintiff had involved in *riba* based transactions and the investment undertaken contained the element of *gharar*.

[32] In this instant case, learned counsel for the defendants submitted that the plaintiff had involved in *riba* transactions when it had levied on the defendants exorbitant and unconscionable profit and late fee charges and it had demanded repayment which is higher than the amount disbursed to the first defendant.

[33] Learned counsel for the defendants posited that *riba* is a loan with the condition that the borrower will return to the lender more than and better than the amount borrowed. According to learned counsel, whatever the extra benefit may be, it should be construed as *riba* and which is not necessarily only interest.

[34] Concerning *gharar*, learned counsel for the defendants submitted that *gharar* in Islamic finance is a term describing a risky or hazardous sale, where details concerning the sale item are unknown or uncertain. *Gharar* is generally prohibited under Islam, which explicitly forbids trades that are considered to have excessive risk due to uncertainty.

[35] In this instant case, it was submitted by learned counsel for the defendants that there is an element of *gharar* because the loans granted by the plaintiff to the first defendant has excessive risk, that is to say, it subjected to pure market demands, a form of speculation. (see Islamic Legal Environment For Trade Related Modes Of Finance by Tariz Kamal Qazi, A & Q).

[36] With respect, I am unable to accept the submission of the learned counsel for defendants..

[37] Now, in order to appreciate the contention by learned counsel for the defendants, it is necessary for the court to examine the true nature of the profit and late fee charges imposed by the plaintiff.

[38] There is no doubt that the defendants already aware that there was several banking facilities granted pursuant to three (3) letters of offer issued to the first defendant. They also realized that the plaintiff claimed the outstanding amounts under three (3) facilities only. There were *Murabahah Tawarruq* 2, *Ijarah* 1, *Ijarah* 2 and *Ijarah* 3, in which the execution of the facilities agreements was not in dispute.

Murabahah Tawarruq

[39] I begin with *Murabahah Tawarruq* facility. *Murabahah Tawarruq* is a transaction that involves purchasing an asset or good with deferred price on the basis of *Murabahah*, then selling it to a third party to obtain cash. (see *Shariah Resolutions In Islamic Finance, Central Bank of Malaysia*, 2010, 2nd edn, p. 224).

[40] *Murabahah* comes from the word *ribh* which means increase. Technically, Murabahah is the mark-up disclosed to the purchaser as per the seller's purchase price for a trust-sale of a certain specified asset, excluding monetary assets such as cash and receivables. (see *The Principles and Practices of Shariah in Islamic Finance, Shariah Parameter Reference 1: Murabahah, Central Bank of Malaysia*, p. 4).

[41] Relying on the aforesaid meanings, one can come to a logical and simple conclusion that *Murabahah Tawarruq* based transaction allows the imposition of profit rate or profit margin. Meaning that, the bank will expressly mentions the cost of the sold goods it has incurred, and sells it to the customer by adding some profit or mark-up on the payment. So long it was accepted by the customer, the term will accordingly binds him/her.

[42] In this instant case, the first defendant will initiate the deal. It will apply *via* purchase request for the plaintiff to purchase certain goods from vendors/suppliers. Upon receipt of the purchase request, the plaintiff will issue a "Letter Of Offer To Sell The Goods" specifying, *inter alia*, the deferred sale price which comprises of the purchase price of the goods, the *Murabahah Profit* imposed and the commodity transaction fee and the first defendant is at liberty to accept it. Once accepted, the first defendant is bound by the terms. (see cl. 2.4 of the *Murabahah Tawarruq* 2 Facility Agreement dated 26 June 2007).

[43] In respect of this kind of transaction, the customer is not interested in owning the asset or goods that the bank acquired, but the instrument is used to facilitate cash advances to him who is in need of cash to pay various needs. (see *Shariah Resolutions In Islamic Finance, Central Bank of Malaysia,* 2010, 2nd edn., p. 224, *Shariah Resolutions In Islamic Finance, Central Bank of Malaysia*, 2007, 1st edn., p. 62, *RHB Islamic Bank Berhad v. Veheng Global Trader Sdn Bhd & Ors* [2011] 1 LNS 684 and cl. 2.2 of the *Murabahah Tawarruq* 2 Facility Agreement dated 26 June 2007).

[44] So too here. The purpose of the facility was to finance the first defendant's general working capital requirements only. That is why, subsequent to the sale between the plaintiff and the first defendant, the latter will appoint the former as its agent to sell the goods so purchased to a third party. (see cl. 2.4 (d) of the *Murabahah Tawarruq* 2 Facility Agreement dated 26 June 2007).

[45] On the above premise, the court found that there is no issue on *riba*. It is true that the lexical meaning of *riba* is increase. However, the court is mindful of the fact that not every increase is prohibited in Islam. For this, I would like to reiterate what Justice Muhammad Taqi Usmani had said in the historic judgment on *riba* (interest) given by the Supreme Court of Pakistan:

> [t] he validity of a financial or commercial transaction does never depend on the financial position of the parties. It rather depends on the instrinsic nature of the transaction itself. If a transaction is valid by its nature, it is valid irrespective of whether the parties are rich or poor. Sale, for example, is a valid transaction whereby a lawful profit is generated. It is allowed regardless whether the purchaser is rich or poor. Lease is a lawful transaction and it is permissible even though the lessee is a poor person. The most one can say is that a poor purchaser or a poor lessee deserves concession on humanitarian grounds, but one cannot say that charging any amount of profit from him is totally haram or prohibited. If a poor person wants to purchase bread from a baker, one can say that the baker should not charge a high profit from him, but no one can say that the baker is obligated to sell the bread to him at his cost and any profit charged by him above the costs is totally unlawful for which he deserves hell. If a poor person hires a taxi, one can advise the owner of the taxi to give some concession to him on the basis of his poverty, but no one can reasonably assert that the owner of the taxi must not charge any fare from him or must not charge a fare higher than his actual expense, otherwise his income will be held as haram and analogous to waging war against Allah and His Messenger. The baker has opened his shop to earn a lawful profit through the transaction of sale which is instrinsically a valid transaction, and he deserves a reasonable profit for his investment and labor, even through the purchaser is poor. If he is obligated to sell his breads to all the poor persons at his cost price, he can neither run his shop nor can earn livelihood for his children. Similarly, the one who runs a taxi for rendering transport services to the passengers is allowed to charge a reasonable fare from those benefiting from his service. If he is required to render his service to all poor persons free of charge, he cannot run the taxi. Nobody has, therefore, even claimed that charging any profit or a fee or a fare from a poor person is totally haram. The reason is that profit, fee and fare, being lawful charges deserved by valid transactions, may be charged from the persons benefiting from the commodities sold or services rendered, even though the benefiting persons are poor. (See Maulana Justice Muhammad Taqi Usmani, *"The Text of the Historic Judgment on Riba 23 December 1999"*, The Other Press, 2001, at pp. 32-3).

[46] In an unreported case of *Bank Islam Malaysia Bhd v. Helcom Engineering Corporation Sdn Bhd & 2 Lagi* (Guaman No: D22A-23-2011), I had the opportunity to explain the element of profit in Islamic financial transactions. I said: A

> [33] The next interesting point raised on behalf of the Defendants was the imposition of interest by the Plaintiff. This is the most popular defence set up by most defendants in Islamic banking cases in this Court. The grounds relied by the Defendants were: B
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> (a) the amount of the Islamic loan is higher than the amount to be restructured under the Original Facilities; and C
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> (b) *ta'widh* was actually an interest imposed by the Plaintiff.
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> [34] The question is: could we equate the profit rate imposed by an Islamic bank with the interest imposed by a conventional bank. For me, this is where a misunderstanding should be clarified. D
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> [35] Malaysia is implementing a dual banking system where the conventional banks and the Islamic banks are operating in parallel as financial intermediaries between the Surplus-Income or Fund Units ("the SFU") who have an excess of available funds among the households, firms and government and Deficit-Income or Fund Units ("DFU") who have a shortage of funds like the 1st Defendant. This channelling of funds is so important as it will allow funds to move from people who lack productive investment opportunities to people who have such opportunities for producing an efficient allocation of capital (wealth, either financial or physical, that is employed to produce more wealth), which contributes to higher production and efficiency for the overall economy. E F
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> [36] As the financial intermediaries, banks are just like other businesses. They are profit oriented. To generate the profit, a bank has three (3) sources of funds namely (i) bank's capital, (ii) bank's reserves or retained earnings and (iii) deposits. Among the three sources, deposits become the main component of a bank's source of funds. So, in this parallel system, both conventional and Islamic banks are competing to attract as much as customers deposits to ensure continuous and adequate funds to sustain its business thus incurring profit for future growth. G H
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> [37] In a conventional bank, the transaction is essentially based on the debtor-creditor relationship. So, receiving deposits from customers means borrowing money from them. In view that money is a commodity that can be traded; therefore, if one uses other people's money, he must pay for doing so in the form of I

A interest. Then, the bank will lend that money out to other bank customers who in need of fund (DFU) with the imposition of another rate of interest which is higher than the one they had to pay on deposit account. In this case, the bank will make its money based on the difference or margin between the interest they pay to depositors and the interest they collect from the borrowers. That is how a conventional bank makes money. The more depositors to the bank, the more funds they get, and the more money they can lend out and the more money they can make by way of interest.

C [38] Similar to a conventional bank, an Islamic bank also uses customer deposits. However, they are different in respect of the underlying concepts and types of contract used to generate profit to ensure its stability in the financial system. Deposits are received under different types of contracts allowed by Shariah and the fund will be utilised to finance various financing and investment activities D requested by the customers like the 1st Defendant depending on the type of Islamic contract the parties chose upon. In this arrangement, the Islamic bank would only generate the profit from the transactions undertaken. This is because, in Islam money is not a commodity that can be traded, hoarded and speculated. E Money is treated as unit of account and a mean of exchange since money by itself performs no function and can only become useful when it is exchanged into a real asset or used to buy a service. Therefore, if parties have agreed to a certain price of a subject matter which would ultimately gives some profit to the Islamic bank, it is permissible as long as the parties agreed to it under F an '*aqad* (for paragraphs 35-38, see Frederic S. Mishkin and Stanley G. Eakins, *Financial Markets and Institutions*, Pearson Prentice Hall, 2009, Sixth Edition, at pp. 4-25, *Introduction to Islamic Capital Market Securities Commission Malaysia*, LexisNexis, 2009 at pp. 5-10, *Islamic Financial System: Principles & Operations*, G International Shari'ah Research Academy for Islamic Finance (ISRA), 2011 at pp. 14-66 and Abu Umar Faruq Ahmad and M. Kabir Hassan, *The Time Value of Money Concept in Islamic Financ*e, The American Journal of Islamic Social Sciences 23:1).

[47] On the same point, the defendants also alleged that the H profits imposed were exorbitant and unconscionable. According to them, this tantamounts to *riba*. Reliance was placed on the higher amount demanded than the amount loaned. This, in my considered view, is obviously unsustainable. My finding is simple: why in the first place did the first defendant agree to the contract?

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[48] People sometimes tend to get confused with the nature of the Islamic facility granted to them. Most of them focus only on the amount approved but not on the nature of underlying contracts in respect of the monies to be utilised. As a consequent, the confusion and misconception about *riba* will be reflected in the arguments put forth by the customers when dealing with the repayment amount to the bank.

[49] To my mind, in order to challenge whether the profit imposed is reasonable or not, the same should be raised before any contract is concluded.

[50] In the case of *Bank Islam Malaysia Berhad v. Adnan Omar* [1994] 3 CLJ 735, it was held that:

> Held:
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> [1] The transactions between the parties were above board and made with the full knowledge of the Defendant who know that the entire exercise was to implement the grant of a loan to him in such a way as to bring the loan transaction within the limits of Islamic Law. His knowledge of this is evidenced by his acceptance of the letter of offer containing all the terms of loan. In the circumstances the parties were *ad idem* in treating the amount of RM583,000 as the facility amount given to the defendant by the plaintiff, which amount coincided with the price of the land in the second sale and purchase agreement whereby the land was resold to the defendant and for which the charge was meant to secure. This being the case, this Court can only accept the Plaintiff's statement of the amount of advance under O. 83 r. 3(3)(e) as being the intention of the parties and the defendant cannot now dispute the amount.

Ijarah

[51] I now turn to *Ijarah* facilities. *Ijarah* is a lease or service contract that involves benefit/usufruct of certain asset or work for an agreed payment or commission within an agreed period. (see *Shariah Resolutions In Islamic Finance*, Central Bank of Malaysia, 2010, 2nd edn, p. 219).

[52] In this instant case, in order to give effect to the *Ijarah* transaction, the first defendant will sell the beneficial ownership of certain assets to the plaintiff and the plaintiff will immediately lease

A the assets to the first defendant whereby the first defendant will pay monthly lease rentals to the plaintiff during the lease term. The first defendant will own the said assets at the expiry or early termination of the lease through a purchase. Here, what is important is that, the *Ijarah* transaction had fulfilled the
B requirement of *Ijarah* contract where there is a willing lessor and willing lessee.

[53] The defendants tried to suggest to this court that the *Ijarah* transaction was in fact a loan because there was no genuine sale
C between the parties as the first defendant never owned the asset before it could be leased out to the plaintiff. According to them, the asset, at all material times, belonged to Alliance Bank Berhad.

[54] As far as the *Ijarah* facility is concerned, the underlying
D subject matter is clearly stated as "the beneficial ownership of certain assets". It does not involve the actual ownership. This, in my considered view, is in line with the purpose of the facility which is to redeem its beneficial ownership of the asset from the first defendant's existing facility with Alliance Merchant Bank
E Berhad, which was used to finance the purchase of the first defendant's assets pursuant to the contract with one Chunghwa Picture Tubes (M) Sdn Bhd.

[55] The same issue was raised in an unreported case *Mohd Alias Ibrahim v. RHB Bank Bhd & Anor* [2011] 4 CLJ 654, by the
F Court Suit No. 22A-74-2010 (the main suit). In this case, one of the Shariah issues referred to the Shariah Advisory Council of Central Bank of Malaysia ("SAC") was:

> Sama ada transaksi *bai' bithaman ajil* (BBA) sah di segi Syariah
G apabila hartanah yang terlibat dalam transaksi tersebut dikatakan tidak berpindah milik berdasarkan kepada Carian Hakmilik yang menunjukkan bahawa Gema Padu adalah dan masih merupakan pemilik berdaftar tanah tersebut.

[56] In response to the issue, the SAC in its 123rd meeting
H resolved as follows:

> Syariah mengiktiraf kesan pemindahan hak milik akad jual beli yang sah **walapun tidak berlaku perubahan nama dalam dokumen pendaftar**. (emphasis added)

I **[57]** Meaning that, Shariah recognizes beneficial ownership over a property or an asset. Therefore, the defendants' contention on this point must fail.

Late Fee Charges vs *Riba*

[58] It was submitted for the defendants that the plaintiff's claim had incorporated amounts of payments for late payments and compensation which contain the element of compensation for the economic loss being a penalty and also *riba*.

[59] Concerning this issue, the relevant provisions are cl. 22 of the *Murabahah Tawarruq* 2 Facility Agreement dated 26 June 2007, cl. 5.5 of the *Ijarah* Agreement dated 10 May 2006, cl. 5.7 of the Master Ijarah Facility Agreement (*Ijarah* Facility 2) dated 10 August 2007 and cl. 5.6(ii) of the KFH *Ijarah Muntahiah Bitamlik* Contract Financing-i III Facility Agreement dated 24 December 2009 which provide the right of the plaintiff to impose *ta'widh* or a compensation fee on late instalments and default payment.

[60] In *CIMB Islamic Bank Bhd v. LCL Corporation Bhd & Anor* [2011] 7 CLJ 594, I have dealt in detail with the meaning of *ta'widh* and its difference from *gharamah*. I do not wish to regurgitate here. In case *Bank Islam Malaysia Berhad v. Helcom Engineering Corporation Sdn Bhd & 2 Ors* (*supra*), the court had referred the following Shariah issue to the SAC:

> Sama ada kadar *ta'widh* boleh ditetapkan dan/atau dipersetujui terlebih dahulu (pre-determined) oleh pihak-pihak di dalam sesuatu perjanjian tanpa dibuktikan kerugian yang dialami oleh pihak Bank.

[61] On 25 August 2011, the SAC had resolved:

> 1. Pihak-pihak yang berkontrak dalam suatu perjanjian tidak boleh menentukan atau mempersetujui terlebih dahulu (pre determined) kadar *ta'widh* berdasarkan perkiraan sesama sendiri.
>
> 2. Namun pihak yang berkontrak boleh bersetuju dengan kadar *ta'widh* yang ditentukan oleh pihak berkuasa. Dalam konteks sektor perbankan, pihak berkuasa merujuk kepada Bank Negara Malaysia.
>
> 3. *Ta'widh* merujuk kepada ganti rugi ke atas kerugian sebenar. Mengambil kira kesukaran dalam menentukan jumlah kerugian sebenar dan keperluan kepada penyelarasan dalam industri, kadar kerugian sebenar hendaklah ditetapkan oleh Bank Negara Malaysia selaku pihak berkuasa. Kadar yang boleh diguna pakai bagi menentukan kerugian sebenar adalah kadar semalaman antara bank secara Islam (daily overnight Islamic Interbank rate), seperti yang dipaparkan dalam laman

A sesawang *Islamic Interbank Money Market* (iimm.bnm.gov.my), ditetapkan pada tarikh penghakiman dibuat dan dikira secara bulanan berasaskan kaedah baki harian (daily rest basis). Maklumat berhubung panduan pengenaan *ta'widh* terkandung dalam perenggan 5.9.2 "Guidelines on the Imposition of Fees and Charges on Financial Products and Services."

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[62] Applying the above resolution, I am of the considered view that the claim for *ta'widh* in this case is lawful.

Gharar

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[63] *Gharar* is an Arabic word. It means uncertainty, danger, peril, jeopardy, hazard or risk. The classical jurists generally agreed that *gharar* brings out the suspicions of danger because of the uncertainty of outcomes of the contract. Al-Zuhaily, a famous contemporary Islamic scholar, maintains that *gharar* is not permitted because its existence, quantity or deliverance is uncertain. This is due to wants of knowledge and lack of control over the time and place of delivery. (see Wan Marhaini Wan Ahmad, *Some Issues of Gharar (Uncertainty) In Insurance, Essential Readings in Islamic Finance*, Centre For Research And Training (CERT), 2008 at pp. 251-253).

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E

[64] According to learned counsel for the defendants, the first defendant's investment in Chunghwa Picture Tubes (M) Berhad had excessive risk because the company was subjected to pure market demands and speculation. The same had ceased business due to drop of market demand of its products. It was alleged that the plaintiff was well aware of the investment and as such the plaintiff ought to participate in the loss as the plaintiff was participating in the profits of the first defendant.

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[65] Obviously there are misunderstandings on the part of learned counsel for the defendants here. First, learned counsel could not appreciate the differences between the purpose of the facility and the nature of the underlying contracts. Second, learned counsel failed to differentiate between the risk (*al-gharar*) and the risk/loss (*al-ghorm*).

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[66] Authorities on issue are legion. For the purpose of this judgment, I would like to refer to the book written by Prof Dr Saiful Azhar Rosly, *Critical Issues on Islamic Banking And Financial Markets*, where in chapter 15 he made distinctions between *gharar* and *ghorm* as follows:

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[o]ne can now distinguish *gharar* from *ghorm*. *Gharar* is destructive while *ghorm* is constructive. Profiting from *gharar* creates unjustified enrichment as it leads to unfair and unethical dealings. On the contrary, profits created under the pretext of *ghorm* show the way to justice since these profits are not made by mere manipulation and deceit but *via* mutual aid and cooperation (*ta'awun*).

As mentioned earlier, contracts containing *gharar* are declared null and void. Sales involving non existent objects, or the non-stipulation of terms of payments are invalid on grounds of *gharar*. Sometimes *gharar* is called *khatar*, taken from the *mukhatara* sale.

Ghorm, however, is something that one must accept in business, as it constitutes a *tabi'* (natural) phenomenon. As mentioned earlier the caravan trade is laden with *ghorm*. Highway robbery, devastating storms, the severe heat during the day and cold in the night, diseases and uncertain markets are some examples of *ghorm* in trade. As such, agents taking part in this venture will hold legitimate claims on any profit made, if any. The term "risk" and "uncertainty" are therefore shorthanded to describe the difference between *gharar* and *ghorm*. In Islamic banking, this term should be used with care. That is:

1. Risk and uncertainties in contractual agreements (ie, ambiguities) are called *gharar*. *Gharar* can be controlled in a sense that it can be deliberately introduced into the contract by either one of the parties.

2. Risks and uncertainties in business outcomes (ie, systematic risks) are known as *ghorm*. *Ghorm* however cannot be eliminated because it is a law in nature (*hukum tabi'*). No one is free from the vagaries of price volatilities arising from market movement.

(see *Understanding Risk and Uncertainty in Islam: Gharar versus Ghorm, Critical Issues on Islamic Banking And Financial Markets*, Dinamas Publishing, 2008 at pp. 73-76)

[67] Relying on the above, it is clear that the risk as alleged by learned counsel for the defendants in the investment undertaken by themselves and on their choice in Chunghwa Picture Tubes (M) Berhad was not *gharar* but *ghorm*. Therefore, the plaintiff should not be dragged into the loss suffered by the defendants as the transaction herein was not on *Mudharabah* or *Musharakah* basis but *Ijarah* and *Murabahah* based where the underlying assets were not the investment in the said company.

[68] Chunghwa Picture Tubes (M) Berhad is only relevant to the plaintiff, where by virtue of a deed of assignment dated 10 May 2006, the first defendant had assigned, *inter alia*, all amounts due to be paid or payable by Chunghwa Picture Tubes (M) Berhad, as the contract awarder, to the first defendant. However, to my mind, this does not mean that the plaintiff ought to have initiated an action against the company before proceeding against the defendants. The document shows that the assignment was given as a security to the payment by the first defendant. Under cl. 9 of the assignment, it authorizes the plaintiff to enforce its right there under and the other security documents concurrently or simultaneously.

Accord And Settlement Between The Parties

[69] Another issue raised by learned counsel for the defendants was the existence of a concluded settlement between the parties. According to learned counsel, after the commencement of the plaintiff's claim, the first defendant entered into negotiations with the plaintiff for a compromise and settlement of the claim. It was submitted that the first defendant had made a proposal and tendered the first six (6) cheques pursuant to its proposal in which the plaintiff had received. Since there was no rejection of the cheques on the part of the plaintiff, the defendants stand was that it was an acceptance of the first defendant's proposal as provided in s. 8 of the Contracts Act 1950.

[70] The court respectfully disagrees. The documentary evidence showed that the six (6) post-dated cheques were accepted by the plaintiff on without prejudice basis and it was not to be construed as a waiver, forbearance or indulgence of any breach or default by the defendants. (see exh. CYS1 of encl. 19). It was expressly stated that the cheques will be used to reduce the sum outstanding due to the plaintiff. Further, it was agreed by the parties that any amendment, modification, waiver or termination of the facilities agreements must be in compliance with strict requirements under the agreements itself. (see for example cl. 23.5 of the Master *Ijarah* Facility Agreement (*Ijarah* facility 2) dated 10 August 2007 and cl. 25 of the *Murabahah Tawarruq* 2 Facility Agreement dated 26 June 2007).

[71] Therefore, the contention by learned counsel for the defendants on this issue shall fail and the plaintiff is at liberty to proceed against the defendants as provided under the facilities agreements.

[72] Before I conclude, perhaps it would be useful to observe that it would have been manifestly unjust for the defendants to avoid their liability to the bank by raising unfounded Shariah issue. In the court's opinion, these "Shariah defences" were "a lawyer construct".

[73] It is instructive to note that Shariah compliance is the basis for the operation and governance of Islamic banking and finance in Malaysia. It is the duty of the Islamic Financial Institutions (IFIs) to ensure that all their activities and operations are Shariah compliant.

[74] The Shariah governance of IFIs in Malaysia consists of two components: Shariah advisors appointed by the respective institution (Shariah Committee ("SC")) and the Shariah apex body, which is the Shariah Advisory Council ("SAC") established by Bank Negara and Security Commission.

[75] Section 3(5) of the Islamic Banking Act 1983 provides that any bank conducting its business based on Islamic principles shall establish a Shariah advisory body to ensure Shariah compliance. In fact, the establishment of an Shariah Committee ("SC") is a requirement for granting a licence to institutions carrying out Islamic banking business. The licence will not be granted unless there is a provision for the establishment of a Shariah advisory body in the IFI's article of association. (see s. 5(a) and (b) of IBA 1983).

[76] The existing legislation states the duties and responsibilities of the SC in a general manner, ie, the SC's duties and responsibilities are to ensure the Shariah compliance of the operations and activities of the Islamic financial institutions. In the present practice, institutions or banks may come up with specific duties and responsibilities of their respective SCs in their practice manuals; however, the institutions may refer to Guideline 20 of the BNM/GPS 1 on the duties and responsibilities of the Shariah Committee ("SC") as follows:

(a) to advise the board of directors on Shariah matters in its business operations;

(b) to endorse Shari'ah-compliance manuals;

(c) to endorse and validate relevant documentation;

A (d) to assist related parties by giving advice on Shariah matters upon request;

(e) to advise on matters to be referred to the SAC;

(f) to provide written Shariah opinions;

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(g) to assist the SAC on reference for advice.

[77] The list suggests that the core of the duties and responsibilities of the committee members is to assist the board of C directors in relation to the business and the operation of Islamic banking business as well as to endorse Shariah compliance manuals. The advisory function of the Shariah Advisory Committee also includes endorsement and validation of relevant documents, the audit and review process, and also advice to related parties D on Islamic finance matters. The stated duties and responsibilities of the SC provide clear evidence that the Shariah is the essence of Islamic finance practices.

[78] With regards to the duties and responsibilities of the Shariah E Advisory Council ("SAC"), s. 16B (4) of the CBA provides that "the Shariah Advisory Council shall have such functions as may be determined by the bank and shall determine its own procedure". Even though this provision does not specifically address the duty of the council, it still can be inferred from that F that their responsibility is to advice on issues pertaining to Islamic financial matters forwarded to them. This has been emphasized in sub-s (7):

> The Bank shall consult the shariah Advisory Council on Shariah matters relating to the Islamic banking business, Takaful business, G Islamic financial business, Islamic development financial business, or any other business which is based on Shariah principles and is supervised and regulated by the Bank, and may issue written directives in relation to those businesses in accordance with the advice of the SAC.

H **[79]** In view of the position of the SAC as the highest authority for decisions on Islamic finance matters, its decisions shall generally be binding on Islamic financial institutions. In the Malaysian context, the legal effect of the SC decisions at their respective financial institutions is instituted by the following legal provisions:

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(1) Guidelines No. 21 (a) and (b) of BNM GPS1 stipulate that the bank has to refer all Shariah issues to its Shariah Committee ("SC") and to adopt all the committee's advice.

(2) Section 13A (1) of the IBA 1983 states that an Islamic bank may seek the advice of the Shariah Advisory Council ("SAC") on Shariah matters in relation to its business and the Islamic bank shall comply with the advice of the Shariah Advisory Council.

(3) Section 123 (3) of BAFIA 1989 clearly stipulates that the bank "may from time to time seek the advice of the Shariah Advisory Council" on the operations of the business to ensure that it does not involve any element which is not approved by Shariah.

(4) The ultimate recognition of the binding effect of the SAC's resolutions is also apparent in s. 16B of the CBA. The section states that in any proceedings relating to Islamic banking business, takaful business, Islamic financial business, Islamic development financial business, or any other business which is based on Shariah principles and is supervised and regulated by Bank Negara Malaysia, the decision of the Shariah advisors may be considered by the courts and is binding on the arbitrator.

[80] The above legislations regulate the binding effect of the SAC's decision on all Islamic financial institutions. Corresponding to this regulation, non-compliance with the decisions or resolutions should be an offence against such regulatory framework and shall be liable for punishments. The CBA 1958 does stipulate penalties in this regard. Section 51 (8) of the Act states: "Any person who contravenes any written directive issued under sub-s 16B(7) shall be guilty of an offence and shall, on conviction, be liable to a fine not exceeding five hundred ringgits, and to a further fine not exceeding five thousand ringgits for every day during which the contravention continues".

[81] Focusing on the internal process necessary to ensure that a product is Shariah-compliant, the Globalpro article (2006) explained a generally acceptable process as follows:

(1) In-house Shariah advisors will make an initial inspection of the products to ensure that:

(a) The pillars and concept implemented are consistent with the Shariah.

(b) The process flow is in line with Shariah.

(c) It fits the Shariah requirement while at the same time abiding with Malaysian law.

(d) If it does not comply, the Shariah advisor should give an alternative or solution.

(2) The outcome of the review and suggestions by the in-house Shariah advisor and bankers will be tabled in an official meeting, and a thorough presentation will be conducted:

(a) Bank officers should disclose all the operational and technical parts of the banking operation.

(b) The in-house Shariah advisors should attest that the presentations are truthful and thoroughly done.

(c) Shariah committee members depend on the information given by the internal officers.

(3) The new product has to be first brought forward to the BNM for approval.

(4) Upon approval, a training session will be conducted to explain the concepts and operational aspects of the product to the bank officers.

[82] The above stringent process is to ensure shariah compliance of all aspects of the product development. (see Research Paper (No: 18/2010): *An Analysis Of The Role And Competency Of The Shariah Committees (SCS) Of Islamic Bank And Financial Services Providers*, published by International Shariah Research Academy for Islamic Finance (ISRA)).

Conclusion

[83] For all the reasons stated above, I allowed the application with costs fixed at RM5,000.